A WORD FROM J.P. MORGAN

Our views on venture

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Some turbulence, but markets resilient on soft-landing potential and lower interest rate outlook.

Most macroeconomic indicators continue to point to a soft landing, as businesses, consumers, and markets have handled inflation and higher interest rates much better than expected. Near-term recession concerns have picked up a little recently but remain low. We have nudged up our own US GDP growth forecast for the year to 2.5%.

After an extended period of higher interest rates, the long-awaited easing cycle officially started with a decisive first Federal Reserve (Fed) cut of 50 basis points at the September meeting. Looking ahead, we think the Fed could move at an orderly pace to bring rates to a neutral, nonrestrictive stance. We will look for another 50 to 75 basis points of cuts before year-end and ongoing 25-basis-point cuts at each meeting in 2025 until reaching a fed funds target rate around 3% by midyear.

In addition to putting less restraint on the demand side of the economy, sustained lower interest rates should benefit company valuations, with high growth profiles receiving the most lift. There is some early evidence of this playing out across public equity markets with smaller caps outperforming large caps by roughly 500 basis points since July. Given an expected lag between public and private markets of nine to 12 months, lower interest rates could filter through the venture capital ecosystem over the course of 2025.

The upcoming presidential election remains an element of uncertainty.

With differences in proposed policies coming into focus and the election outcome too close to call, some uncertainty remains for the economic and market outlook. The candidates appear furthest apart on tax policy, trade and tariffs, green initiatives, and immigration. Given the tight race, the makeup of Congress will also influence what policies are ultimately implemented.

Interestingly, the candidates appear to align on their tough stances vis-à-vis Big Tech, albeit for different reasons. In recent years, increased regulation and antitrust enforcement have effectively sidelined the largest technology companies from M&A activity. While we don't think this dynamic has been the primary reason behind the lack of consolidation among startups this cycle, we are cautiously optimistic the market tone for smaller deals in the technology sector could improve with a change in administration.

Stabilization in venture activity overall belies the tale of two cities within the ecosystem.

Venture capital flows overall appear to be levelling off around pre-pandemic levels, with heightened activity around a few sectors offsetting ongoing challenges across many others. AI and cyber infrastructure continue to garner significant investment activity with little valuation sensitivity, and the best-performing startups continue to raise capital on attractive, founder-friendly terms. Underscoring this dynamic, data from Aumni, a J. P. Morgan company, shows the recovery in top-quartile valuations across stages towards pre-pandemic levels, while the divergence between top-quartile and median valuations this year has widened.[1]

Carly Roddy, co-head of North America private capital markets, notes that VCs continue to be highly selective and discerning when putting money to work. Aside from in-favor sectors and the strongest performers, finding new lead investors continues to prove difficult, as the usual lead investors

1: Aumni, a J.P. Morgan company, is a leading provider of investment analytics software to the venture capital industry.

have reduced their deal activity and lead cadence. Some investors are expressing capacity constraints as triage and portfolio management remain top priorities.

Roddy also notes that deal dynamics continue to trend investor-friendly for much of the ecosystem. In this environment, rational valuations are being prioritized over commercialization and growth, resulting in the increased prevalence of down rounds, structured rounds, and lower volumes of valuation markups. Based on Aumni data, down rounds climbed to nearly 25% at midyear, up from the 2% at the peak of the cycle in mid-2021. There are notable differences in trends between early and late stage, with early-stage down rounds stable to improving, while late-stage down rounds step changed higher through the first half of this year. It is likely these figures understate the reality, as insider-led down rounds and extensions often go unreported. Stage-to-stage post-money valuation markups have been less frequent and more muted, even though this appears to have stabilized around +60% and begun to trend in the right direction.

As funds seek to deliver DPI, or distributed to paid-in capital, to limited partners amid the prolonged lull in venture-backed exits, we have seen increased activity in secondary markets. Direct secondary market conditions appear to be improving, with positive price action and narrower bid/offer spreads year to date.

Optimism is building that 2025 can be the turning point in venture-backed company capital markets activity.

Greg Chamberlain, co-head of technology equity capital markets, sees the setup for 2025 as supporting an acceleration in IPO activity for the startup ecosystem. Improved clarity on the economy, interest rates, and the election should generally bolster confidence to transact. Plus, improved trading performance from the 2024 IPO cohort has helped in restoring investor perception of the asset class and interest in high-quality equity issuance has been increasing. With only a few months left in the year, IPO volumes appear on track to reach or slightly exceed $30 billion for 2024. Prior to the pandemic, a normal year for IPO markets was $40 billion-$45 billion in total issuance and included 35-40 tech IPOs. Chamberlain notes that given pent-up demand and several scaled, profitable, and growing private companies, it is possible 2025 could be better than normal, assuming the macro and market backdrop remain benign.

Along with our expectation for increased IPO activity next year, we expect an improved environment for M&A. There are numerous startups in the ecosystem with good business models that have reached profitability and maintained liquidity. Founders may be holding out for improved IPO conditions to assess going public. Many will dual-track their exit opportunities and choose the path that offers the best potential outcome over time.

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